



## Federal Housing Finance Agency

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July 6, 2010

Honorable Edmund G. Brown, Jr.  
Attorney General  
State of California  
1515 Clay Street  
20<sup>th</sup> Floor  
Oakland, California 94612-0550

Dear Attorney General Brown:

Thank you for speaking with me this weekend. I was sorry to take time away from your holiday. I indicated that I will contact you again and see what specifics can be addressed per our discussion.

As you know, in earlier communications, you indicated concerns about the Property Assessed Clean Energy (PACE) programs and actions by Fannie Mae and Freddie Mac. The Federal Housing Finance Agency (FHFA) has reviewed the PACE programs again, considered safety and soundness issues that they present in their current form, carefully reviewed the status of current underwriting and energy standards, had further discussions with federal and state officials and undertaken to clarify the position of Fannie Mae and Freddie Mac on existing PACE program loans.

FHFA has determined that the first liens associated with PACE loans undertaken as tax assessments present a safety and soundness issue. Nevertheless, FHFA has directed the Enterprises to waive the clauses in their Uniform Security Instrument, prohibiting loans with a senior priority, for loans made prior to today's date, thereby addressing the concerns of existing homeowners with such first lien PACE loans.

Because of safety and soundness concerns, FHFA is directing Fannie Mae, Freddie Mac and the Federal Home Loan Banks to undertake certain actions that address PACE programs with first lien provisions. These are described in the attached FHFA Statement. In the meantime, FHFA believes a pause in PACE and PACE-like programs would be beneficial to permit a complete review of the relevant issues set forth in the attached Statement. FHFA intends to continue working with all parties toward a cooperative and well developed model for energy retrofit lending.

While these actions are taken as a prudential matter, FHFA supports energy retrofit lending programs. As we have for the past year, FHFA remains committed to working with federal and state government agencies and with the private sector to assess what programs could be deployed

or what currently existing programs may be modified that would operate to protect consumers, to facilitate lending while avoiding risks to lenders, to provide clarity on energy efficiency and to make energy conservation a goal that is being actively pursued at the residential level.

If you have any questions, you may contact me at 202 414 3788.

With all best wishes, I am

Sincerely,

A handwritten signature in cursive script, reading "Alfred M. Pollard". The signature is written in dark ink and is positioned above the printed name and title.

Alfred M. Pollard  
General Counsel

Attachment

cc: Clifford Rechtschaffen  
Janill L. Richards

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# FEDERAL HOUSING FINANCE AGENCY



## STATEMENT

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For Immediate Release  
July 6, 2010

**Contact:** Corinne Russell (202) 414-6921  
Stefanie Mullin (202) 414-6376

### **FHFA Statement on Certain Energy Retrofit Loan Programs**

After careful review and over a year of working with federal and state government agencies, the Federal Housing Finance Agency (FHFA) has determined that certain energy retrofit lending programs present significant safety and soundness concerns that must be addressed by Fannie Mae, Freddie Mac and the Federal Home Loan Banks. Specifically, programs denominated as Property Assessed Clean Energy (PACE) seek to foster lending for retrofits of residential or commercial properties through a county or city's tax assessment regime. Under most of these programs, such loans acquire a priority lien over existing mortgages, though certain states have chosen not to adopt such priority positions for their loans.

First liens established by PACE loans are unlike routine tax assessments and pose unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors. The size and duration of PACE loans exceed typical local tax programs and do not have the traditional community benefits associated with taxing initiatives.

FHFA urged state and local governments to reconsider these programs and continues to call for a pause in such programs so concerns can be addressed. First liens for such loans represent a key alteration of traditional mortgage lending practice. They present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation.

While the first lien position offered in most PACE programs minimizes credit risk for investors funding the programs, it alters traditional lending priorities. Underwriting for PACE programs results in collateral-based lending rather than lending based upon ability-to-pay, the absence of Truth-in-Lending Act and other consumer protections, and uncertainty as to whether the home improvements actually produce meaningful reductions in energy consumption.

Efforts are just underway to develop underwriting and consumer protection standards as well as energy retrofit standards that are critical for homeowners and lenders to understand the risks and rewards of any energy retrofit lending program. However, first liens that disrupt a fragile housing finance market and long-standing lending priorities, the absence of robust underwriting standards to protect homeowners and the lack of energy retrofit standards to assist homeowners, appraisers, inspectors and lenders determine the value of retrofit products combine to raise safety and soundness concerns.

On May 5, 2010, Fannie Mae and Freddie Mac alerted their seller-servicers to gain an understanding of whether there are existing or prospective PACE or PACE-like programs in jurisdictions where they do business, to be aware that programs with first liens run contrary to the Fannie Mae-Freddie Mac Uniform Security Instrument and that the Enterprises would provide additional guidance should the programs move beyond the experimental stage. Those lender letters remain in effect.

Today, FHFA is directing Fannie Mae, Freddie Mac and the Federal Home Loan Banks to undertake the following prudential actions:

1. For any homeowner who obtained a PACE or PACE-like loan with a priority first lien prior to this date, FHFA is directing Fannie Mae and Freddie Mac to waive their Uniform Security Instrument prohibitions against such senior liens.
2. In addressing PACE programs with first liens, Fannie Mae and Freddie Mac should undertake actions that protect their safe and sound operations. These include, but are not limited to:
  - Adjusting loan-to-value ratios to reflect the maximum permissible PACE loan amount available to borrowers in PACE jurisdictions;
  - Ensuring that loan covenants require approval/consent for any PACE loan;
  - Tightening borrower debt-to-income ratios to account for additional obligations associated with possible future PACE loans;
  - Ensuring that mortgages on properties in a jurisdiction offering PACE-like programs satisfy all applicable federal and state lending regulations and guidance.

Fannie Mae and Freddie Mac should issue additional guidance as needed.

3. The Federal Home Loan Banks are directed to review their collateral policies in order to assure that pledged collateral is not adversely affected by energy retrofit programs that include first liens.

Nothing in this Statement affects the normal underwriting programs of the regulated entities or their dealings with PACE programs that do not have a senior lien priority. Further, nothing in these directions to the regulated entities affects in any way underwriting related to traditional tax programs, but is focused solely on senior lien PACE lending initiatives.

FHFA recognizes that PACE and PACE-like programs pose additional lending challenges, but also represent serious efforts to reduce energy consumption. FHFA remains committed to working with federal, state, and local government agencies to develop and implement energy retrofit lending programs with appropriate underwriting guidelines and consumer protection standards. FHFA will also continue to encourage the establishment of energy efficiency standards to support such programs.

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*The Federal Housing Finance Agency regulates Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks. These government-sponsored enterprises provide more than \$5.9 trillion in funding for the U.S. mortgage markets and financial institutions.*